

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF CALIFORNIA

VISION SERVICE PLAN,

NO. CIV. S-04-1993 LKK/JFM

Plaintiff,

v.

O R D E R

UNITED STATES OF AMERICA,

Defendant.

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In 1960, Vison Service Plan ("VSP") was granted status as a tax-exempt organization. In 1999, the IRS commenced an examination of VSP. The IRS concluded that VSP was not entitled tax-exempt status under Internal Revenue Code, 26 U.S.C., ("IRC"), Section 501(c)(4). Def.'s SUF, 1. The IRS issued a final adverse determination letter to VSP, revoking its IRC Section 501(c)(4) status, effective prospectively from January 1, 2003. Def.'s SUF, 2. The following year, VSP paid the tax owed on its 2003 earnings, and then filed this suit.

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1 Pending before the court are cross-motions for summary
2 judgment. VSP seeks a determination that it is a social welfare
3 organization under 501(c)(4), a refund of its income tax payment
4 for 2003 and an order that the United States issue it a private
5 letter recognizing VSP's status under 501(c)(4). The United States
6 seeks summary judgment on the grounds that VSP does not qualify for
7 exemption under 501(c)(4).

8 **II.**

9 **STANDARDS**

10 Summary judgment is appropriate when it is demonstrated that
11 there exists no genuine issue as to any material fact, and that the
12 moving party is entitled to judgment as a matter of law. Fed. R.
13 Civ. P. 56(c); See also Adickes v. S.H. Kress & Co., 398 U.S. 144,
14 157 (1970); Sicor Limited v. Cetus Corp., 51 F.3d 848, 853 (9th
15 Cir. 1995).

16 Under summary judgment practice, the moving party

17 [A]lways bears the initial responsibility of
18 informing the district court of the basis for
19 its motion, and identifying those portions of
20 "the pleadings, depositions, answers to
21 interrogatories, and admissions on file,
together with the affidavits, if any," which
it believes demonstrate the absence of a
genuine issue of material fact.

22 Celotex Corp. v. Catrett, 477 U.S. 317, 323 (1986). "[W]here the
23 nonmoving party will bear the burden of proof at trial on a
24 dispositive issue, a summary judgment motion may properly be made
25 in reliance solely on the 'pleadings, depositions, answers to
26 interrogatories, and admissions on file.'" Id. Indeed, summary

1 judgment should be entered, after adequate time for discovery and
2 upon motion, against a party who fails to make a showing sufficient
3 to establish the existence of an element essential to that party's
4 case, and on which that party will bear the burden of proof at
5 trial. See id. at 322. "[A] complete failure of proof concerning
6 an essential element of the nonmoving party's case necessarily
7 renders all other facts immaterial." Id. In such a circumstance,
8 summary judgment should be granted, "so long as whatever is before
9 the district court demonstrates that the standard for entry of
10 summary judgment, as set forth in Rule 56(c), is satisfied." Id.
11 at 323.

12 If the moving party meets its initial responsibility, the
13 burden then shifts to the opposing party to establish that a
14 genuine issue as to any material fact actually does exist.
15 Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574,
16 586 (1986); See also First Nat'l Bank of Ariz. v. Cities Serv. Co.,
17 391 U.S. 253, 288-89 (1968); Sicor Limited, 51 F.3d at 853.

18 In attempting to establish the existence of this factual
19 dispute, the opposing party may not rely upon the denials of its
20 pleadings, but is required to tender evidence of specific facts in
21 the form of affidavits, and/or admissible discovery material, in
22 support of its contention that the dispute exists. Fed. R. Civ.
23 P. 56(e); Matsushita, 475 U.S. at 586 n.11; See also First Nat'l
24 Bank, 391 U.S. at 289; Rand v. Rowland, 154 F.3d 952, 954 (9th Cir.
25 1998). The opposing party must demonstrate that the fact in
26 contention is material, i.e., a fact that might affect the outcome

1 of the suit under the governing law, Anderson v. Liberty Lobby,
2 Inc., 477 U.S. 242, 248 (1986); Owens v. Local No. 169, Assoc. of
3 Western Pulp and Paper Workers, 971 F.2d 347, 355 (9th Cir. 1992)
4 (quoting T.W. Elec. Serv., Inc. v. Pacific Elec. Contractors Ass'n,
5 809 F.2d 626, 630 (9th Cir. 1987), and that the dispute is genuine,
6 i.e., the evidence is such that a reasonable jury could return a
7 verdict for the nonmoving party, Anderson, 477 U.S. 248-49; see
8 also Cline v. Industrial Maintenance Engineering & Contracting Co.,
9 200 F.3d 1223, 1228 (9th Cir. 1999).

10 In the endeavor to establish the existence of a factual
11 dispute, the opposing party need not establish a material issue of
12 fact conclusively in its favor. It is sufficient that "the claimed
13 factual dispute be shown to require a jury or judge to , 04-
14 1993 resolve the parties' differing versions of the truth at trial."
15 First Nat'l Bank, 391 U.S. at 290; See also T.W. Elec. Serv., 809
16 F.2d at 631. Thus, the "purpose of summary judgment is to 'pierce
17 the pleadings and to assess the proof in order to see whether there
18 is a genuine need for trial.'" Matsushita, 475 U.S. at 587
19 (quoting Fed. R. Civ. P. 56(e) advisory committee's note on 1963
20 amendments); see also International Union of Bricklayers & Allied
21 Craftsman Local Union No. 20 v. Martin Jaska, Inc., 752 F.2d 1401,
22 1405 (9th Cir. 1985).

23 In resolving the summary judgment motion, the court examines
24 the pleadings, depositions, answers to interrogatories, and
25 admissions on file, together with the affidavits, if any. Rule
26 56(c); See also In re Citric Acid Litigation, 191 F.3d 1090, 1093

1 (9th Cir. 1999). The evidence of the opposing party is to be
2 believed, see Anderson, 477 U.S. at 255, and all reasonable
3 inferences that may be drawn from the facts placed before the court
4 must be drawn in favor of the opposing party, see Matsushita, 475
5 U.S. at 587 (citing United States v. Diebold, Inc., 369 U.S. 654,
6 655 (1962) (per curiam)). Nevertheless, inferences are not drawn
7 out of the air, and it is the opposing party's obligation to
8 produce a factual predicate from which the inference may be drawn.
9 See Richards v. Nielsen Freight Lines, 602 F. Supp. 1224, 1244-45
10 (E.D. Cal. 1985), aff'd, 810 F.2d 898, 902 (9th Cir. 1987).

11 Finally, to demonstrate a genuine issue, the opposing party
12 "must do more than simply show that there is some metaphysical
13 doubt as to the material facts. . . . Where the record taken as a
14 whole could not lead a rational trier of fact to find for the
15 nonmoving party, there is no 'genuine issue for trial.'" Matsushita, 475 U.S. at 587 (citation omitted).

17 III.

18 ANALYSIS

19 The issue to be resolved in the cross-motions is whether VSP
20 qualifies for tax exempt status under 26 U.S.C. § 501(c)(4).
21 Below, I explain why plaintiff's motion for summary judgment must
22 be denied and defendant's motion for summary judgment must be
23 granted.

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1 **A. APPLICABLE LAW¹**

2 A taxpayer seeking exemption from taxation has the burden of
3 proving by clear and convincing proof that he is within a specific
4 exemption clause. Club Gaona, Inc. v. United States, 167 F.Supp.
5 741, 746 (S.D. Cal. 1958).

6 Section 501(c)(4) of the Internal Revenue Code (26 U.S.C.A.
7 § 501(c)(4)) provides federal tax exemption to a social welfare
8 organization. Section 501 provides, in pertinent part, that
9 "organizations not organized for profit but operated exclusively
10 for the promotion of social welfare" shall be exempt from taxation.
11 26 U.S.C. §§ 501(a) and 501(c)(4)(A).

12 Although the words "exclusively" and "primarily" have
13 different meanings, courts interpret the word "exclusively"
14 to mean, "primarily." See American Women Buyers Club, Inc. v.
15 United States, 338 F.2d 526, 528 (2nd Cir. 1964) ("The word
16 'exclusively' as used in the statute has not been given a strict
17 interpretation . . . but rather has been interpreted to mean
18 'primarily.'") (citing Debs Memorial Radio Fund, Inc. v.
19 Commissioner, 148 F.2d 948, 952 (2nd Cir. 1945)).

20 In like fashion, the regulations provide:

21 An organization is operated exclusively for the
22 promotion of social welfare if it is primarily engaged
23 in promoting in some way the common good and general
24 welfare of the people of the community. An organization
embraced within this section is one which is operated primarily

25 ¹ Because resolution of these motions require a fact-
26 intensive inquiry, the court will eschew a separate exposition of
the facts. The facts discussed during the analysis section are
undisputed, unless indicated otherwise.

1 for the purpose of bringing about civic betterments and social
2 improvements.

3 26 C.F.R. § 1.501(c)(4)-1(a)(2).

4 The regulations go on to provide that an organization is not
5 operated primarily for the promotion of social welfare if its
6 primary activity is "carrying on a business with the general public
7 in a manner similar to organizations which are operated for
8 profit." 26 C.F.R. § 1.501(c)(4)-1(a)(2)(ii).

9 In essence, VSP must establish that it is (1) not organized
10 for profit; and (2) that it operates primarily for the promotion
11 of social welfare. 26 C.F.R. § 1.501(c)(4)-1(a)(I)& (ii). As I
12 explain below, VSP is unable to demonstrate satisfaction of either
13 of the two requisite criteria.²

14 **B. THE PROMOTION OF SOCIAL WELFARE**

15 Plaintiff maintains that it qualifies for exemption under 501
16 (c)(4) because "it is operated primarily for the promotion of
17 social welfare." Pl.'s Mot. for Summ. J. at 2:20. VSP claims to
18 serve broad segments of the community through direct services as
19 well as through charity work. While VSP's charitable work is
20 admirable, VSP cannot establish that it operates primarily for the
21 promotion of social welfare within the meaning of the tax

22 ² Defendant places great reliance of cases addressing
23 qualification for tax exempt status under § 501(c)(3). That
24 reliance is inapposite. Section 501(c)(3) and (c)(4) address
25 different circumstances and have different criteria for exemption.
26 Moreover, the three 503(c)(3) cases discussed by VSP are
distinguishable as they involve actual health care providers or
HMOs. As discussed in the text, plaintiff is not a health care
provider.

1 regulations.

2 The Treasury regulation provides that:

3 An organization embraced within this section is one
4 which is operated primarily for the purpose of bringing
about civic betterments and social improvements.

5 26 C.F.R. § 1.501(c)(4)-1(a)(2).

6 Thus, to qualify an organization must be "a community movement
7 designed to accomplish community ends." Erie Endowment v. United
8 States, 316 F.2d 151, 156 (3d Cir. 1962).

9 It is frequently the case that an organization is found not
10 to qualify under 501(c)(4) because it is operating primarily for
11 the benefit of its members, rather than for the purpose of
12 benefitting the community as a whole. See, e.g., Contracting
13 Plumbers Co-op. Restoration Corp. v. United States, 488 F.2d 684,
14 686 (2d Cir. 1973) (plumbers cooperative not tax exempt as benefits
15 were proportional to member's financial involvement); American
16 Women Buyers, 338 F.2d at 528 (association not tax exempt as
17 majority of benefits were for members and did not promote social
18 welfare). In sum, where organizations provide substantially
19 different benefits to the public as compared to its private
20 members, it is not "primarily" devoted to social welfare as
21 required by Section 501(c)(4). Id. at 687. In essence, even
22 though there may be aspects of the organization that greatly
23 benefit society, if the majority of the organization's services
24 benefit private members, the organization cannot qualify for an
25 exemption under 501(c)(4). Moreover, it has also been held that
26 "[t]he presence of a single substantial non-exempt purpose

1 precludes exempt status regardless of the number or importance of
2 the exempt purpose." Contracting Plumbers, 588 F.2d at 686.

3 Finally, it is pertinent to the instant case to note that the fact
4 that an organization promotes health care, or is part of the health
5 care industry, does not, alone, ensure exempt status within the tax
6 code. See IHC Health Plans Inc. v. Commissioner of Internal
7 Revenue, 325 F.3d 1188, 1197 (10th Cir. 2003).

8 The test for qualification under 501(c)(4) is stringent.
9 For instance, in Commissioner of Internal Revenue v. Lake Forest,
10 Inc., 305 F.2d 814 (4th Cir. 1962), the court found that a
11 membership-based organization involved in providing housing for
12 veterans did not qualify. The court explained:

13 Lake Forest does, of course, furnish housing to a
14 certain group of citizens but it does not do so on a
15 community basis. It is a public-spirited but
16 privately-devoted endeavor. Its work in part
17 incidentally redounds to society but this is not the
18 'social welfare' of the tax statute.

17 C.I.R. v. Lake Forest, Inc., 305 F.2d at 818. The court further
18 explained that classification as "'civic' or 'social' depends upon
19 the character - as public or private - of the benefits bestowed,
20 of the beneficiary, and of the benefactor." Id.

21 As applied to the case at bar, the court concludes that
22 despite VSP's charity work, the membership-based structure as well
23 as the types of services offered, demonstrate that VSP's primary
24 activity is not the promotion of social welfare. I begin this part
25 of the analysis with an examination of VSP's service structure.

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1 **1. VSP's Clients**

2 Plaintiff argues that VSP serves a broad cross section of the
3 California community. See Pl.'s Mot. for Summ. J. at 27:12-16.
4 While this may be true, VSP's primary activity is to defray and
5 assume "the costs of professional vision care by establishing a
6 fund from periodic payments by subscribers or beneficiaries, from
7 which fund said costs may be paid." Decl. of Jeremy N. Hendon, Ex.
8 A, VSP's Articles of Incorporation, at Article II. VSP contracts
9 with employers, health maintenance organizations, insurance
10 companies, and political subdivisions ("subscribers") to arrange
11 for the provision of vision care services and vision supplies to
12 the subscribers' employees or members ("enrollees"). Def.'s SUF,
13 3.

14 VSP provides services to subscribers and through them, to
15 enrollees. A non-enrolled individual may not simply walk in off
16 the street to receive care. Def. SUF, 6. Although VSP does
17 provide services through charity programs, these services to non-
18 enrollees are not, comparatively, substantial. Much like the
19 organizations at issue in Lake Forest or Contracting Plumbers
20 Cooperative, the benefits that VSP provides to the public are
21 incidental and not the primary purpose of VSP. VSP's primary
22 purpose is to serve VSP's paying members.

23 VSP argues that there are several factors favoring a finding
24 of tax exempt status. They note that (1) many of VSP's subscribers
25 are small businesses, a consideration under the Internal Revenue
26 Manual in evaluating tax exempt status, Pl.'s SUF 27; (2) many VSP

1 doctors serve areas designated as medically needy or under served.
2 Pl.'s SUF, 90-91.; (3) VSP provides vision care for many Medicaid
3 and Medicare participants; and (4) VSP services low income children
4 through the California Healthy Families Child Health Assistance
5 Program ("Healthy Families"), Pl.'s SUF, 30. The court now
6 addresses each of these contentions.

7 **a. Small Employers & Servicing Rural Areas**

8 Servicing small employers or rural subscribers and enrollees
9 does not equate to promoting social welfare. See Def. Opp'n at 24:
10 14-22. Small employers or rural employers are still paying for
11 VSP's services and VSP is making a profit from these contracts.
12 VSP submits that the Internal Revenue Manual lists servicing
13 smaller employers and rural enrollees as a factor in determining
14 if an HMO qualifies for exemption under 501(c)(4). See Pl.'s Mot.
15 for Summ. J. 27:20-22. This argument is unavailing. Even
16 assuming arguendo the binding character of the manual, a dubious
17 proposition, VSP is not an HMO, i.e. it does not provide medical
18 services, it is instead what is known in the trade as a bundler.³

19 **b. Medicaid, Medicare and Healthy Families enrollees**

20 VSP argues that servicing Medicaid, Medicare and Healthy
21 Families participants is a central part of how VSP promotes social
22 welfare.

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24
25 ³ There is nothing pejorative in the term, it simply notes
26 a functional difference between providers, and an organization that
arranges for the provision of services.

1 In 2003, VSP covered more than 2.1 million Medicaid and
2 Medicare participants for vision care. These enrollees comprised
3 31.4% of VSP's total enrollment. Pl.'s SUF, 29. Combined with the
4 children VSP served through Healthy Families, these three groups of
5 enrollees represented 41.5% of VSP's total enrollment in 2003. VSP
6 submits that it suffered substantial losses from providing services
7 to Medicaid, Medicare and Healthy Families participants. See
8 Pl.'s SUF, 35. VSP argues that these facts support a finding that
9 VSP is primarily engaged in promoting social welfare. The court
10 cannot agree.

11 First, VSP competitively bid for the Medicaid, Medicare and
12 Healthy Families contracts. See Def.'s Mot. for Summ. J., Hendon
13 Dec., Ex. H at 137-41. As defendant notes:

14 The criterion for an Enrollee to receive VSP's services
15 is not whether such person is a member of a medically
16 underserved population. Rather, the criterion is
17 whether the Enrollee is an employee or member of a
18 paying Subscriber (e.g., the State of California) which
contracts with VSP for a fee. That is, VSP does not
focus on individuals who need medical care, but focuses
on its Subscribers with whom VSP contracts for a fee.

19 Def. Mot. for Summ. J. at 11:15-19.

20 Second, in calculating the alleged losses, VSP includes
21 discounts given by participant doctors. This does not appear
22 appropriate. As the court understands it, the providing doctor
23 incurs the loss and not VSP.⁴ Therefore, the court does not accept

24 ⁴ Defendant's example is helpful in understanding how it is
25 that VSP does not absorb the loss:

26 For example, suppose the customary doctor fee was \$100

1 as accurate the alleged "losses" as calculated by plaintiff. See
2 Pl. Mot. for Summ. J., Cochran Dec., Ex. K.

3 Third, from all that appears, the Medicaid, Medicare and
4 Healthy Families programs are profitable for VSP. As defendant
5 maintains, if VSP refused to reduce its fees for these contracts,
6 "VSP would lose a substantial volume of business, albeit at reduced
7 fees." Def.'s Opp'n to Pl. Mot. for Summ. J. at 27:23-26.

8 Fourth, VSP claims that in 2003, excluding doctor discounts,
9 VSP spent \$4,296,055.00 on discounts and underwritten losses for
10 Medicare, Medicaid and Healthy Families participants. Pl.'s. Mot.
11 for Summ. J., Cochran Dec. Ex. N. Even if the court accepts VSP's
12 numbers as accurate, this expenditure of \$4,296,055.00 is a
13 relatively small fraction of VSP's net income for 2003, which was
14 \$34,487,626.00, id., and an even smaller fraction of VSP's gross
15 income for 2003, which was \$425 million. Def.'s Mot. for Summ. J.,
16 Hendon Dec., Ex. K.

17 Even if the court concluded that servicing these specific
18 enrollees could constitute promoting social welfare, these
19 enrollees make up less than half of VSP's total enrollment, thus
20

21 per patient and the reduced doctor fee for Subscribers
22 with Medicare enrollees was \$75 per patient; VSP does not
23 suffer a \$25 loss because, while it receives \$75 per
24 patient from the Subscriber, it is required to pay the
25 doctor provider only \$75 per patient, not \$100. Thus,
26 there is no net "loss" to VSP. The doctor is the only
participant who arguably suffers a "loss."

Def. Opp'n at 27:15-19.

Moreover, even there the "loss" suffered by the provider is
only as compared to his usual fee.

1 again negating a conclusion that VSP is "primarily engaged" (much
2 less exclusively engaged) in promoting social welfare.

3 _____While VSP does in fact offer services to these groups, it is
4 also very clear that servicing these particular enrollees is not
5 VSP's primary activity. Put directly, VSP is operating primarily
6 for the benefit of its subscribers rather than for the purpose of
7 benefitting the community as a whole. This conclusion precludes
8 VSP from exemption under 501(c)(4). See, e.g., Contracting
9 Plumbers, 488 F.2d at 686; American Women Buyers Club, 338 F.2d
10 at 528.

11 **2. VSP's Charity Services**

12 Plaintiff maintains that VSP provides free vision care to
13 "substantial numbers of non-enrollees under VSP's charity
14 programs." Pl.'s SUF, 23. It is true that VSP provides vision
15 care services to non-enrollees. Nonetheless, the provision of
16 these services is comparatively small, and again, does not
17 establish that VSP is primarily engaged in promoting social
18 welfare.

19 There are two main programs through which non-enrollees might
20 receive vision care services: the Sight for Students program and
21 disaster relief efforts.

22 **a. Sight for Students**

23 This program targets children of families earning up to 200%
24 of the poverty level and who do not participate in other eyecare
25 insurance programs. VSP's free services under the program include
26 eye examinations, eyeglasses, medically-necessary contact lenses,

1 vision therapy and low vision treatment. These services are
2 available for students up to age 18 or through graduation from high
3 school. Pl.'s SUF, 37. The Sight for Students children and their
4 families select a VSP doctor and present a VSP service
5 authorization (voucher). The VSP doctor then provides services and
6 is paid standard VSP contract rates by VSP or a local VSP
7 affiliate. VSP or an affiliate bears the cost of the providers'
8 services and of the glasses or contacts provided under the plan.
9 Pl.'s SUF, 39.

10 _____In 2003, VSP spent \$2.8 million dollars on this program, Pl.'s
11 Mot. for Summ. J., Cochran Dec., Ex. N, and provided services for
12 12,558 children. Id., Ex. H. When one compares \$2.8 million,
13 however, with VSP's net or gross income, it appears that the amount
14 spent on this program is not substantial. Indeed, children
15 receiving care under the Sight for Students program constituted
16 only .19% of VSP's total enrollment. Taken together, these facts
17 support a finding that VSP is not primarily engaged in the
18 promotion of social welfare.

19 **b. Disaster Relief Services**

20 In conjunction with the American Red Cross, VSP also
21 contributes to disaster relief by providing free exams and
22 replacement glasses to disaster victims. VSP provides vouchers to
23 chapters of the American Red Cross for free services. Disaster
24 victims may present these authorizations to VSP providers to
25 receive free examinations and glasses, for which VSP reimburses the
26 providers. Pl.'s SUF, 41.

1 In 2003, VSP provided services for 285 people compared to a
2 total enrollment of 6 million, Pl.'s Mot. for Summ. J., Cochran
3 Dec., Ex. H, and spent roughly \$73,132.00. Id. Again, compared
4 to either VSP's net income or gross income, the amount spent on
5 disaster relief services is minimal.

6 **3. VSP's Community Outreach and Community Education**

7 In addition to providing services to non-enrollees, VSP also
8 engages in educational and community outreach. These programs
9 include: (1) Get Focused Campaign; (2) Health Care Vision Project;
10 (3) Vision USA; (4) Eye on Health Patient Newsletter; (5)
11 Optometric Education and Research; (6) Clinical Guidelines and
12 Algorithms; and (7) Paid Time Off for Volunteer Service. See Pl.'s
13 Mot. for Summ. J. at 34-36. VSP claims that these programs, in
14 conjunction with the services provided to Medicaid, Medicare and
15 Health Families participants, support a finding that it is
16 primarily engaged in the promotion of social welfare. The court
17 cannot agree.

18 While these programs are admirable and important, they do not
19 demonstrate VSP being primarily involved in the promotion of social
20 welfare. In 2003, VSP spent \$3,893,496.00 on these programs. See
21 Pl.'s Mot. for Summ. J., Cochran Dec., Ex N. This includes the
22 Sight for Students Program, as well as disaster relief services.
23 Again, this is a very small fraction of VSP's gross or net income
24 for 2003.

25 Plaintiff submits that, taken together, VSP's charity work and
26 service to Medicaid, Medicare and Healthy Families participants

1 demonstrates that VSP should be exempt under the requirements of
2 501(c)(4). VSP's own numbers do not support such a conclusion.

3 In 2003, VSP spent roughly 8 million dollars on charity work.
4 See Pl.'d Mot. for Summ. J., Cochran Decl., Ex. N. This number
5 does not include doctor discounts, but does include the costs that
6 VSP allegedly incurred providing services to Medicaid, Medicare and
7 Healthy Families participants.

8 Even assuming that VSP's calculations are accurate, eight
9 million dollars is 24% of VSP's 2003 net income and an even smaller
10 percentage of VSP's gross income. In sum, these programs and
11 services do not demonstrate that VSP is primarily engaged in the
12 promotion of social welfare. While VSP does contribute to the
13 betterment of society, like the organization in Lake Forest, it is
14 a "publicly spirited but privately-devoted endeavor." Lake Forest,
15 305 F.2d at 818. VSP's work "incidentally redounds to society but
16 this is not the 'social welfare' of the tax statute." Id.

17 Put directly, the court must conclude that VSP's services are
18 most beneficial to private paying members, the subscribers and the
19 enrollees. Like the members of the plumbers cooperation in
20 Contracting Plumbers, members of VSP enjoy the benefit of VSP's
21 services precisely to the extent that members use and pay for the
22 services. Contracting Plumbers, 488 F.2d at 687. Serving the
23 interests of these private subscribers is clearly a non-exempt
24 purpose. Id. This non-exempt purpose destroys VSP's exemption
25 status, regardless of the number or importance of truly exempt
26 purposes. Id.; American Women Buying Club, 338 F.2d at 528.

1 **C. NOT OPERATING FOR PROFIT**

2 Plaintiff submits that VSP was organized as a non-profit and
3 operates like one. VSP points to its by-laws, which provides in
4 pertinent part:

5 This Corporation shall operate as a nonprofit
6 corporation and shall be organized and operated
7 exclusively for the promotion of social welfare within
8 the meaning of Section 501(c)(4) of the Internal Revenue
9 Code of 1986, as amended, or any successor provision.
10 The Corporation shall maintain and operate a voluntary
11 nonprofit vision care plan to provide care to
12 subscribers to such plan under contracts which entitle
the subscribers to certain eye care; to provide eye care
to medically underserved persons, whether or not
subscribers to such plan; to provide public education
regarding vision and vision care; to perform such
services in a manner that benefits the community; and to
engage in any and all lawful activities necessary and
incidental thereto.

13 Pl.'s SUF, 3.

14 The issue, however, is not whether plaintiff is a nonprofit
15 corporation for corporation law purposes, but whether it is one for
16 federal tax purposes.

17 To qualify for an exemption under 501(c)(4), an organization
18 must establish that it operates exclusively for the promotion of
19 social welfare. According to the Treasury regulations, an
20 organization is not operated primarily for the promotion of social
21 welfare if its primary activity is "carrying on a business with the
22 general public in a manner similar to organizations which are
23 operated for profit." 26 C.F.R. § 1.501(c)(4)-1(a)(2)(ii).

24 Moreover, a corporation that devotes much of its revenues to
25 improving its ability to compete commercially through accumulation
26 of large surpluses and expansion of its income producing facilities

1 is not entitled to exemption under Section 501(c)(4). People's
2 Educational Camp Soc. Inc. v. C.I.R., 331 F.2d 923, 932 (2d Cir.
3 1964).

4 In this regard, I begin by noting that VSP engages in cost-
5 cutting measures common to for-profit businesses. For example, a
6 portion of VSP's bonus structure paid to its employees is directly
7 tied to reducing VSP's costs. Def.'s SUF, 24. See also Def.'s
8 SUF, 25 and 26. (discussing other ways that VSP cuts costs).

9 Second, VSP strives to remain competitive in ways that do not
10 appear to be consistent with the operations of a non-profit. For
11 example, VSP pays commissions to brokers who bring new clients.
12 In 2003, VSP paid \$19 million in broker commissions. (This is more
13 than VSP spent on charity work in 2003, Pl.'s Mot. for Summ. J.,
14 Cochran Dec., Ex. N). The broker's commission is calculated based
15 on the revenue that VSP receives from each new client. Def.'s SUF,
16 29. See also Def.'s SUF, 30-31.

17 Moreover, the court is unable to agree with plaintiff that
18 no one profits from its activities. Although VSP's by-laws provide
19 that VSP has no equity owners who are entitled to share in its net
20 earnings, in fact VSP executives and officers receive bonuses that
21 are taken directly from the net earnings. See Def.'s Resp. to
22 Pl.'s SUF, 4 (discussing VSP executive bonuses and how bonuses are
23 calculated). Furthermore, VSP offers its executives high salaries
24 and other forms of compensation that are more consistent with a
25 for-profit corporation than an non-profit. For example, Roger
26 Valine, the Chief Executive Officer of VSP, although not required

1 to work full time, was paid a \$395,000 base salary for 2003, in
2 addition to a sizable bonus plan. Def.'s SUF, 37 & 44. Chief
3 officers and executives are also provided with luxury company cars.
4 See Def.'s SUF, 47-49. VSP specifically targeted the executives'
5 salaries to median market levels, making no distinction between
6 salaries paid to executives working at for-profit businesses, and
7 executives working at non-profit entities. Def.'s SUF, 38. See
8 also Def.'s SUF, 40-41;47-49 (describes other ways that executives
9 are compensated).

10 The court concludes that VSP carries on business with the
11 public "in a manner similar to organizations which are operated for
12 profit." 26 C.F.R. § 1.501(c)(4)-1(a)(2)(ii). Therefore, VSP
13 does not operate primarily for the promotion of social welfare.

14 **D. CONCLUSION**

15 Plaintiff has failed to establish that it qualifies for exempt
16 status under 501(c)(4). VSP is not operated "exclusively for the
17 promotion of social welfare" as provided for in 501(c)(4). For
18 these reasons, summary judgment for the defendant, United States,
19 is GRANTED. Summary judgment for the plaintiff, VSP, is DENIED.
20 The Clerk is directed to ENTER judgment accordingly and CLOSE the
21 case.

22 IT IS SO ORDERED.

23 DATED: December 12, 2005.

24 /s/Lawrence K. Karlton
25 LAWRENCE K. KARLTON
26 SENIOR JUDGE
UNITED STATES DISTRICT COURT